

European Community

Political Setting

The EC--30 years old this year--has become the dominant policy organ in Western Europe. The early passion for creating a federal Europe has been replaced by a pragmatic realization that steady though plodding progress toward economic integration and foreign policy coordination is the most that can be expected. The Community has been a back-bench participant at the annual Economic Summits since 1977. All twelve members will be represented in the EC delegation, which will contain representatives of both the Commission and the Council of Ministers. We expect that EC Commission President Jacques Delors, a former French finance minister, will speak for the EC in the areas over which it has direct competence. These include agriculture, trade--and to a lesser extent--macroeconomic and monetary policy. He will overshadow Belgian Prime Minister Wilfred Martens, whose country holds the rotating presidency of the Council of Ministers, on economic issues. Martens, however, may speak for the Community on political issues. [REDACTED]

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Economic Setting

The EC continues to struggle with consistently high unemployment and a failure to compete with the United States and Japan on the same technological level. The two key items on the Community's agenda--the

budget and overcoming obstacles to the creation of a unitary EC internal market--illustrate in turn how the EC as an institution can both hinder and help in finding solutions to the economic problems of the member states. The chronic budget crisis, exacerbated by a falling dollar and to a large extent the result of farm spending, dominates the EC's time and energy and divides the members along north-south lines. According to Commission estimates, a projected \$5.7 billion shortfall in the 1987 Community budget will occur by October. Delors has proposed a long-range solution which would raise available revenues by tying national contributions to GNP. Members are unlikely to agree to this, however, until spending is brought under control. The effort to liberalize the internal EC market has made some initial progress in improving the competitive environment. But it is in danger of floundering because members are reluctant to give up control over elements of strong national concern--such as border controls and indirect taxation--for the sake of freer trade. [REDACTED]

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Goals for the Summit

EC representatives will have both positive and negative goals at the Summit. On the positive side they will probably be most interested in expanding cooperation to stabilize exchange rates and in maintaining pressure on Japan to cut its trade surplus. These issues are of particular importance to the Community because they are directly related to the stability of the European Monetary System (EMS), the EC budget, and EC

trade policy. On the defensive side, we believe the EC representatives will want to avoid any language in the Summit statement committing the Community to specific action on agriculture. [REDACTED]

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Economic Issues

Macroeconomic Policy Coordination and International Monetary Reform

The EC is likely to call for greater economic policy coordination and expansionary fiscal policies in Japan and in Europe at the Summit. Delors is likely to suggest that West Germany--and, to a lesser extent the UK and France--should take the lead in reviving growth prospects in Europe by accelerating tax cuts and tax reform measures, as well as boosting public investment. He is unlikely to push the point too hard though because of German resistance to playing "locomotive" for the world economy. Delors also may argue, consistent with a Commission-prepared plan to boost growth in the EC, that throughout Europe government infrastructure spending and private investment must be expanded and that labor agree to slow the growth of real wage costs in order to make a dent in EC unemployment. [REDACTED]

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The Community's top priority in the monetary area is to prevent a further decline of the dollar and ensure the stability of the EMS. The EC's effort to liberalize member state capital markets by 1992--in which Delors takes a personal interest--requires a strong and highly stable EMS, and a further collapse of the dollar would almost certainly force another

realignment of EMS currency rates. Delors will continue to advocate close and continuing cooperation to stabilize exchange rates, building on recent Group of Seven agreements. He may call on the United States to do more for dollar stability by cutting its fiscal deficit and adopting a more restrictive monetary policy. [REDACTED]

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Structural Adjustment

At the Summit Delors is likely to promote the EC's effort to complete the internal market by 1992 as the central element of the Community's attempts to assist restructuring of European economies. This effort to guarantee complete freedom of movement for goods, services, capital, and persons has been the Community's top economic priority for the past two years, and is fully supported by the member states, though they are failing to keep up with the decisionmaking schedule because of disagreements over details. It is aimed at reducing bureaucratic interference in business decisions and giving EC firms the advantages of a more unified home market to help improve competitiveness, and has been moderately successful so far. Delors reportedly also favors a British plan within the EC to remove bureaucratic restrictions on small businesses and to make them a focus of employment creation within the Community. [REDACTED]

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Agriculture--Reform and Trade

The EC is likely to want to focus the Summit's work on agriculture toward a statement calling for progress on reform at the GATT Uruguay Round. The Community has endorsed the recent OECD call for gradual and balanced reductions in agricultural subsidies, and is likely to support appeals to stabilize markets and end aggressive export practices. Delors may support the creation of a grain exporter's cartel, although he is aware of US antipathy to this idea. He probably will not be amenable to a statement calling for an early, separate agreement on agriculture at the GATT round. He will likely resist any attempt to single out the CAP for criticism, pointing to progress already made on cutting milk and beef production since last year. [REDACTED]

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In general, both Delors and the Commission as a whole are strong supporters of agricultural reform, though they are unable to accelerate reform proposals because of the need in practice for unanimous agreement among the member states. Pressure for reform of the Common Agricultural Policy (CAP)--consuming \$25 billion a year, or two-thirds of EC spending--is building because of the EC's chronic budget crisis. The Commission this year has proposed a price freeze for most commodities, a price cut of almost three percent for grain, an expanded role for the free market in farm sales, and a radical plan allowing national direct payments to farmers whose incomes fall below a regional average. The direct income payment plan is likely eventually to facilitate agreement among the members on price cuts and acreage reductions, essential steps toward lower

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production, reduced export subsidies, and a smaller budgetary burden. We believe the Community will agree on a reform package--probably including price cuts and strictly monitored direct income payments--that will incrementally improve the operation of the CAP's subsidy system, probably not until after the Summit. [REDACTED]

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The Commission's proposed tax on vegetable oil production--potentially affecting annual US soybean exports to the EC of \$2.5 billion--may still be under consideration by EC agricultural ministers at the time of the Summit, even though it is likely to fail eventually because of strong resistance from the UK and West Germany. These countries are concerned about the prospect of another serious trade dispute with the United States. To the extent reform measures reduce the CAP budget, revenue provided by the tax would be less needed. Nevertheless, the tax could be raised in bilateral discussions at the Summit. [REDACTED]

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Third World Debt

The Commission has no real competence in the area of debt, but Delors is likely to argue in favor of maintaining enlarged LDC access to IMF resources, increasing World Bank lending, and macroeconomic policies aimed at expanding developed country growth, as partial solutions to the problem. [REDACTED]

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New Round and International Trade

An important EC priority will be to maintain pressure on Japan to take concrete measures to cut its trade surplus with the Community. The surplus increased by over 50 percent in 1986, to \$17 billion, and the Commission fears that because the yen has not appreciated as much against European currencies as against the dollar Japan is refocusing its export drive on the EC. Delors will probably argue for greater Japanese import promotion, export restraints, and a restructuring of the economy toward domestic-led growth. He may also stress that Japan, which has benefited greatly by the international trading system, should take a larger share of the responsibility for adjusting the trade imbalance, by reducing its huge trade surplus. The EC is currently challenging Japan on a large number of trade issues: dumping of computer printers, dumping of components for so-called "screwdriver" plants, dumping of semiconductor chips, and the US-Japan semiconductor agreement. [REDACTED]

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Delors would likely support a statement calling for early agreement--around mid-1988--on issues at the Uruguay Round, but only if it does not single out agriculture for "fast track" treatment. The Commission is firmly committed to strengthening the multilateral trading system and has said that it intends to play a major role in the success of the round. Delors may also voice Commission concerns about the threat of protectionism in the United States. The Commission has threatened retaliation should legislation in the US Congress to restrict textile imports into the United States come into effect. [REDACTED]

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Political Issues

Arms Control and Disarmament

Last month in an interview in France Delors proposed holding an EC summit to discuss General Secretary Gorbachev's arms control proposals, even though as President of the Commission he has no direct competence on the issue. Neither he nor Martens are likely to pursue this idea in the presence of non-EC members at the Venice Summit. [REDACTED]

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South Africa

Most EC members oppose further economic sanctions against Pretoria, but Martens may endorse a Summit statement condemning apartheid. This would be consistent with a planned EC statement, which may be issued in late May. The Community also hopes to foster closer ties with the Frontline States in southern Africa, and would endorse a statement to that effect. Budgetary constraints, however, preclude large scale aid. [REDACTED]

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Middle East

Martens is likely to encourage support--especially from the United States--for a UN-sponsored Middle East peace conference. Since February EC officials have been promoting the idea through diplomatic contacts with likely participants. [REDACTED]

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